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Release copies to District

Date April 30, 1997

Surname [REDACTED]

MAR 19 1997

Employer Identification Number:
Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in section 501(c)(6) of the Internal Revenue Code. For the reasons stated below, we conclude that you do not qualify for tax exemption under this section. Your protest rights are also explained below.

You were incorporated on August 26, 1986, under the nonprofit statute of the [REDACTED] Article Third of your incorporating instrument states that your purposes are,

"(1) To arrange by contract for the delivery or provision of health services by individuals, entities and facilities licensed or certified to practice medicine and other health professions, and, as appropriate, ancillary medical services and equipment, by which arrangements such health care providers and suppliers will provide their services in accordance with and for such compensation as may be established by a contract between the Corporation and one or more health maintenance organizations which has been granted a certificate of authority pursuant to the [REDACTED] as amended."

Subparagraph (iii) of Article Third provides that,

"Notwithstanding any other provision of this Certificate of Incorporation to the contrary, nothing contained herein shall authorize the Corporation to establish, operate, construct, lease or maintain a hospital or to provide hospital service or health related service or to operate a drug maintenance program, a certified home health agency, a hospice, or a health maintenance organization, or to provide a comprehensive health services plan as defined and covered by [REDACTED]"

Initiator [REDACTED] Reviewer [REDACTED] Reviewer [REDACTED] Reviewer [REDACTED] Reviewer [REDACTED]

Code [REDACTED]

Surname [REDACTED]

Date 3/18/97

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Article EIGHTH states that, "This Certificate of Incorporation is for the incorporation of an existing unincorporated association known as the [REDACTED]"

By-Laws, Article II is entitled Members. Section 2.1(a) provides that your membership shall consist of "(i) physicians who hold current and unrestricted licenses to practice medicine or osteopathy, as the case may be (except interns, residents, or fellows in any hospital or similar institution) from or recognized by the licensing authorities [REDACTED] who are members in good standing of the medical staff of [REDACTED] who maintain an annual admission rate at either [REDACTED] of not less than (x) seventy-five (75%) percent of the total number of the physician's hospitalized patients, or (y) seventy-five (75%) percent of the total number of the physician's hospitalized patients who are covered under a third-party payor managed care plan, and who meet such other requirements and conditions as the Board of Directors may from time to time establish; and (ii) such other health care professionals (except interns, residents or fellows in any hospital or similar institution), as the Board of Directors from time to time may designate by profession and/or specialty, and who meet such membership qualifications as the Board of Directors from time to time may impose with respect thereto."

By-Laws, Article IV, Section 4.1 provides that your Board of Directors shall establish a Membership/Credentials Committee, a Quality Assurance/Peer Review Committee, a Negotiating and Reimbursement Committee, and a Finance Committee. Each Committee shall consist of not less than three (3) Members.

In response to Part II, 1 of Form 1024, exemption application, concerning your activities, you essentially repeat the language found in Article THIRD, subparagraph (i) of your Certificate of Incorporation.

In response to Part II, 2, you state that you are supported, in order of magnitude, by membership fees and administration fees. For your taxable year ending June 30, 1995, you report (in Part III) total revenue of \$276,061, including \$276,020 in membership dues. Total expenses were \$20,883, including \$18,129 in legal fees. Net excess for the period equals \$255,178. For your taxable year ending June 30, 1996, you report total revenue of \$126,251, virtually all from membership fees (\$126,214). Expenses totalled \$75,533, including \$64,701 in "service fees". This results in a net excess of \$50,718 for this taxable period.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of nonprofit business leagues, chambers of commerce, and boards of trade, whose net earnings do not inure to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations defines a business league as an association of persons having some common business interest, the purpose of which is to promote such common business interest and not to engage in a business of a kind ordinarily carried on for profit. The regulations further require that a business league's activities be directed to the improvement of business conditions for one or more lines of business as distinguished from the performance of particular services for individual persons.

Rev. Rul. 86-98, 1986-2 C.B. 74 describes M, a nonprofit membership corporation which is an individual practice association (IPA) pursuant to section 1302(5) of the Health Maintenance Organization Act of 1973, 42 U.S.C.A. section 300e-1(5) (1982). M's stated purpose is to arrange for the delivery of health services through written agreements negotiated with health maintenance organizations (HMOs).

M's membership is limited to licensed physicians who are engaged in the active practice of medicine and who are members of a specified county medical society. The activities of M are managed by an executive committee which is elected by the membership of M. The bylaws of M require that a majority of the executive committee be members of M.

M's members generally maintain a private medical practice in addition to performing services for M. All members are required to enter into written service contracts with M which provide:

(1) that the members shall provide their professional services to HMO patients in accordance with a compensation arrangement negotiated between M and the HMOs;

(2) that the members shall, to the extent feasible, share medical and other records, equipment and professional, technical, and administrative staff; and

(3) that the members will limit referrals of HMO patients, to the extent feasible, to other participating members.

M's primary activities are to serve as a bargaining agent for its members in dealing with HMOs, and to perform the administrative claims services required by the agreements negotiated with the HMOs. M is paid a capitation amount by each HMO based on the number of HMO subscribers entitled to receive medical services. Members bill M for services rendered to the HMO subscribers and accept claims payment for M as payment for services rendered. Members agree to reimbursement by M on a fee-for-service basis according to a fee schedule established by the board of directors of M. The fee schedule reflects the usual customary fees charged by the member-physicians in their private medical practice.

Rev. Rul. 86-98 first cites section 501(c)(4) of the Code, which provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2) of the regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the community. An organization embraced within this section is one that is operated primarily for the purpose of bringing about civic betterments and social improvements.

Rev. Rul. 86-98 then cites section 501(c)(6) of the Code and section 1.501(c)(6)-1 of the regulations, discussed above.

The ruling notes that M functions as a billing and collection service, as well as a collective bargaining representative negotiating on behalf of its member-physicians with HMOs. Further, M does not provide to HMO patients access to medical care which would not have been available but for the establishment of M, nor does it provide such care at fees below what is customarily and reasonably charged by members in their private practices.

Rev. Rul. 86-98 holds that M does not qualify for tax exemption under Code section 501(c)(4) on the following basis:

[REDACTED]

Thus, M operates in a manner similar to organizations carried on for profit, and its primary beneficiaries are its member-physicians rather than the community as a whole. See Rev. Rul. 75-199, 1975-1 C.B. 331, which provides examples of mutual, self-interest organizations that do not qualify for exemption under section 501(c)(4) of the Code. Accordingly, M is not operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4).

Also, M does not qualify for tax exempt status under section 501(c)(6) under the following rationale:

In addition, because the billing and collection services provide an economy or convenience to M's members relating to the operation of their private medical practices, M is primarily performing particular services for its members. See Rev. Rul. 71-175, 1971-1 C.B. 153. Thus, the organization is rendering particular services for individual persons as distinguished from the improvement of business conditions in the medical profession and public health area generally. Membership in the organization is restricted to physicians who are subject to M's written service contract. Thus, M does not better conditions for all physicians in a particular community, but, instead, is devoted to maximizing fees for its members. See National Muffler Dealers Association, Inc. v. U.S., 440 U.S. 479 (1979). Therefore, M is not operated as a business league within the meaning of section 1.501(c)(6)-1 of the regulations.

With respect to your own application under section 501(c)(6), the contract negotiation and administrative services which you provide to your physician members constitute "particular services" under section 1.501(c)(6)-1 of the regulations. You are essentially no different than the individual practice association described in Rev. Rul. 86-98, discussed above. Prior to your incorporation, you were organized as an [REDACTED].

While you have not applied for recognition of tax exemption as a social welfare organization described in Code section 501(c)(4), the holding in Rev. Rul. 86-98 would preclude such status. The primary beneficiaries of your planned activities are your physician-members rather than the community in which you operate.

There is another substantive ground for denial of tax exempt status for you under section 501(c)(6), as follows:

Courts have interpreted the "line of business" requirement set forth in section 1.501(c)(6)-1 of the regulations to mean either an entire industry, see American Plywood Association v. United States, 267 F. Supp. 830 (W.D. Wash. 1967); and National Leather and Shoe Binders Association v. Commissioner, 9 T.C. 121 (1947), acq. 1947-1 C.B. 3, or all components of an industry within a geographic area, see Commissioner v. Chicago Graphic Art Federation, 128 F. 2d 424 (7th Cir. 1942); Crooks v. Kansas City Hay Dealers' Association, 37 F. 2d 83 (8th Cir. 1929); and Washington State Apples Inc. v. Commissioner, 46 B.T.A. 64 (1942), acq. 1942-1 C.B. 17.

In Rev. Rul. 68-182, 1968-1 C.B. 263 (based on Technical Information Release 952, dated December 26, 1967), the Service announced that it will not in similar cases follow the decision entered November 10, 1966, by the United States Court of Appeals, Seventh Circuit, in Pepsi-Cola Bottlers' Association, Inc. v. United States, 369 F. 2d 250 (1966).

In that case, the Court held that the Association, whose members are engaged in the bottling and sale of a single franchised soft-drink product, and whose purposes and activities were directed to the more efficient production and sale of that product, qualified for tax exemption as a business league described in section 501(c)(6) of the Code.

The Service stated its position that "organizations promoting a single brand or product within a line of business do not qualify for exemption from Federal income tax under section 501(c)(6) of the Code. See Produce Exchange Clearing Association, Inc. v. Helvering, 71 F. 2d 142 (1934) Ct. D. 898, C.B. XIII-2, 209 (1934)."

In 1977, the Second Circuit endorsed the Service's position and embraced the "segment" of a line of business theory. See National Muffler Dealers Association, Inc. v. United States, 565 F. 2d 845 (2d Cir. 1977). The Second Circuit specifically rejected the Seventh Circuit's Pepsi-Cola decision.

The National Muffler Dealers Association was organized in 1971, under the New York Not-For-Profit Corporation Law, as a trade association of "Midas Muffler" dealers. Although the Association's Certificate of Incorporation described its purpose as the promotion of the best interests of muffler dealers generally, its first set of bylaws restricted membership to muffler dealers holding a valid Midas franchise. The bylaws were later amended to allow any muffler franchise to join. The Association was successful in gaining certain concessions for its members from Midas and it also provided a number of supplemental services of benefit only to its members, such as insurance programs and a newsletter. The Association held an annual convention at which issues of concern to Midas dealers were discussed.

The Court confronted what it called the "lexicographer's task of deciding what is meant by a 'business league'." Because the statute provided no direct guidance, the Court applied the maxim noscitur a sociis, "(i)t is known from its associates", Black's Law Dictionary 1209 (Rev. 4th ed. 1968), and looked "at the general characteristics of the organizations" with which business leagues were grouped in the statute, that is, chambers of commerce and boards of trade. The court agreed with the Service's determination, in section 1.501(c)(6)-1 of the regulations, that a business league is an "organization of the same general class as a chamber of commerce or board of trade."

After examining chambers of commerce and boards of trade, the Court recognized that the "common characteristic of the organizations enumerated in section 501(c)(6) is that they foster well-being within a broadly defined segment of the commercial sector." The Court went on to say that it was, "the manifest intention of Congress in section 501(c)(6) to provide an exemption for organizations which promote some aspect of general economic welfare rather than support particular private interests. The 'line of business' requirement contained in the regulations is well suited to assuring that an organization's efforts do indeed benefit a sufficiently broad segment of the business community."

The Court concluded that the National Mufflers Dealers Association did not qualify for tax exemption under section 501(c)(6) of the Code. The Court found that the Association did not draw its members from a broad base, in that all members had a well-defined business relationship to a single private firm, Midas. This relationship precluded tax exempt status because, "to the extent that the Association is successful in improving conditions for its members, it does so partially at the expense of non-Midas dealers, who will find themselves facing stronger competition."

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[REDACTED]

The line of business requirement was upheld by the Supreme Court of the United States in National Muffler Dealers Association v. United States, 440 U.S. 472 (1979), which concluded that the requirement is a reasonable interpretation of Code section 501(c)(6). As the Court stated,

"In sum, the 'line of business' limitation is well grounded in the origin of section 501(c)(6) and in its enforcement over a long period of time. The distinction drawn here, that a tax exemption is not available to aid one group in competition with another within an industry, is but a particular manifestation of an established principle of tax administration. Because the Association has not shown that either the regulation or the Commissioner's interpretation of it fails to 'implement the congressional mandate in some reasonable manner', United States v. Correll (68-1 USTC section 9101) 389 U.S. at 307, the Association's claim for a section 501(c)(6) exemption must be denied."

With respect to your own application under Code section 501(c)(6), we conclude that you do not meet the "line of business" requirement set forth in the regulations and upheld by the Supreme Court of the United States. Specifically, your membership is limited, for the most part (if not exclusively), to physicians who are on the [REDACTED]

Above, we have cited court decisions to the effect that "line of business" means either an entire industry or all components of an industry within a given geographic area.

Based on the foregoing, we hold that you do not qualify for exemption from federal income tax under section 501(c)(6) of the Code. Accordingly, you are required to file federal income tax returns on Form 1120.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

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If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director, Northeast (Brooklyn, NY), which is your key district for exempt organization matters. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

When sending a protest or other correspondence with respect to this case, you will expedite its receipts by using the following address on the envelope:

Internal Revenue Service
Attn: [REDACTED]
1111 Constitution Avenue, NW
Washington, DC 20224

Sincerely,

[REDACTED]